Perspectives on AER discussion paper – regulatory tax review

Network Shareholders Group

Spark Infrastructure, Morrison & Co, AMP Capital, IFM Investors, MIRA, AustralianSuper, CDPQ

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Who are we & what is our role?

- We are **responsible custodians** of the retirement savings of millions of Australians via their superannuation funds as well as the capital of hundreds of global institutional investors
- We have invested over **$12 billion** in Australian energy transmission and distribution network businesses
- Key stakeholders in creating a network that **minimises costs** to consumers, **responds effectively** to technology transition, decarbonises and provides **reliability**
- Investments in networks is required to eliminate pricing disparities with the energy market and facilitate entry of new low-cost generation that will reduce costs to consumers
- Funding and capital is mobile – regulatory interventions are leading to changes in behaviour for investors with global opportunities and dry up funding for Australia

The capital needed to ensure affordable and reliable networks for consumers will be funded by investors like us

The tax context

- The Federal Treasury has undertaken several significant reviews into various tax arrangements within infrastructure investment
- These structures were intended to achieve broader national economic objectives by facilitating the investment by domestic and international parties and fund the development of Australian infrastructure
- There have already been significant changes in Federal Government's policy on stapled structures as well as vehicles for offshore investors which will reduce gap between regulatory tax allowance and tax paid
- These issues are rightly the domain of Commonwealth tax policy across the economy rather than the economic regulation of energy networks

The AER review is taking place in a context of significant changes to tax policy relating to infrastructure investment structures

Initial views on recent AER discussion paper and process

- In the main we welcome the principles adopted by the AER in the report – particularly incentive based approach and BEE
- We are still digesting the implications of the suggested changes to tax practices
  - Timing differences that could have significant ‘step change’ impacts on customers and investors
  - Implementation and transition issues
  - Not clear what further information on interest expense will reveal if incentive based approach and use of BEE is maintained
- We are pleased that the AER has acknowledged the changes to taxation policy
- We commend the AER team on the process undertaken to engage with stakeholders
  - Issues have high complexity, requiring sophisticated analysis and understanding of tax issues and policy interactions
  - We believe the AER has addressed the issues raised by stakeholders and sought to understand relevant material and implications

We applaud the AER for the engagement undertaken and look forward to understanding its full position

Incentive based regulation is in the long term interests of consumers

- We welcome the AER's confirmation that retaining an incentive based approach with reference to a benchmark efficient entity is in the long term interests of consumers
- This approach ensures that:
    - Customers pay no more than the efficient cost of providing regulated network services
    - Strong incentives to achieve efficiencies and apply efficient tax practices remain
    - The complexity and cost of administering the regulatory framework are minimised

Restores some certainty and stability in times of frequent and significant change in the energy sector

The benchmark efficient entity <u>is</u> an Australian company subject to a 30% tax rate

- We support the AER's approach to maintain the 30% tax rate
  Supported by the AER's experts
  - Is the applicable tax rate for the majority of NSPs – less than 17% pay less than 30%
  - Changes in legislation will reduce the likelihood that entities will pay tax lower than 30% in the future
  - Does not distort efficient decisions regarding ownership and structure
- The RAB and TAB are the appropriate asset values
  - Supported by the AER's experts
  - Consistent with ring fencing the regulated services
  - Insulates customers from higher costs due to re-valuation and acquisition

A different conclusion is not supported by the information or appropriate given tax changes

Potential changes to efficient taxation practices – initial reactions

- Depreciation – essentially timing differences
  - Change in approach to immediate expensing and diminishing value may have minimal impact on customers over the life of assets
    - **Potentially significant impact on investors** in the short term ($100s of millions of dollars across the sector over a 5 year period)
    - **Potential for significant windfall gains** or losses to individual NSPs and their customers depending on stage of cycle
  - Implementation details not clear
    - Changes must be prospective and recognise ability of BEE to implement the change
- Interest expense – not clear what further information will reveal
  - Current approach supported by analysis and recommendations on other issues – asset revaluations, stamp duty, tax pass through
  - Must be consistent with incentive based approach and assumed benchmarks
  - Customers should not pay for (or benefit from) financing costs and benefits driven by non-regulated businesses and services

Issues still under consideration

Framework for assessing changes

- We support the AER's criteria for evaluating options
  - Does it reflect the efficient costs of operating the regulated network?
  - Is the change material?
  - Is it achievable tax practice?
  - Are there broader tax issues?
- Further consideration should include:
  - Ensuring outcomes for customers are not affected by ownership – government, private, Australian or otherwise
  - Impacts on Government policy of encouraging investment
  - The impact on the profile of prices over the life of assets of each change and all changes together
  - The impact of tax changes on long-term investment incentives *in globo* with changes to ROR and gamma
  - The costs of implementing the change
  - The impact of changes on predictability and stability that increase risk

The benefits to customer should be material enough to off-set potential increases in costs and risk

Next Steps

- Undertake more detailed review of the positions and supporting materials
- Assess impacts over life of assets as well as impact of change in the short term
- Consider transition and implementation issues and costs
- Look forward to continued dialogue with the AER on outstanding issues
- Provide response and supporting information in submission

The final assessment needs to consider impacts on all stakeholders, policy objectives and investment signals